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Strongly increasing revenues from single premium payments allowed life insurance companies to return to growth. Non-life and accident insurance business, however, weakened considerably. Despite an increase in the number of contracts, premium intakes declined. In private health insurance, the industry expanded its risk pool while price increases were moderate even though the number of claims increased in line with additional hospital treatments. Preparations for the changeover to Solvency II, to be carried out at the start of 2016, still keep the industry busy, because the new supervisory regime also calls for adjustments in the organisational structure of insurance companies. The regulation in pillars 1 and 2 of Solvency II will raise the fixed cost component in the insurance industry and thereby increase returns to scale.

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The strong increase in single premium payments in life insurance brought a three-year period of decline to an end, as premium revenues grew by 4.5 percent. While private health insurance continued its upward trend (+3.3 percent), non-life and accident insurance (–3.2 percent) suffered from fragile macroeconomic conditions in 2014. These divergent trends made for an overall stable level of premium revenues by Austrian insurance companies (Table 1), while the composition of revenues shifted somewhat towards life insurance.

Life insurance premiums in Austria are low by international standards.

Insurance penetration, i.e., the ratio between domestic direct premium revenues and nominal GDP, measures the demand for private insurance services in a country and lends itself to international comparisons. Since directly charged premiums increased by 3.3 percent in 2014, the sustained decline in insurance penetration over the last years turned around. At 5.2 percent it is nevertheless low compared to the Western European average of 6.8 percent. The gap mainly derives from a rather low popularity of life insurance products in Austria (2 percent against 4.8 percent for Western Europe), whereas Austria's insurance penetration in non-life insurance is slightly above the Western European average (3.2 percent vs. 3 percent; *Swiss Re*, 2015).

51 insurance companies newly registered for the Austrian market in 2014.

For insurers domiciled in the European Economic Area (EEA), the Austrian insurance market became substantially more attractive in 2014 than in the years before. Insurance companies from the EEA enjoy privileged access to the Austrian market vis-à-vis insurers from third countries, since they remain under home country supervision. In 2014, 30 EEA insurance companies covered the Austrian market via branches. For the direct exchange of services, 953 companies were registered, hence 51 additional providers are potentially active in the Austrian market. Data on revenues of these new providers in Austria are not yet available.

Table 1: Adjusted gross premiums

	All branches	Life insurance	Health insurance	Non-life and accident insurance	Insurance penetration[1]
	Million €	As a percentage of total premium			As a percentage of GDP
2010	18,713	40.0	8.8	51.2	5.7
2011	18,922	36.7	9.0	54.3	5.3
2012	18,743	34.6	9.4	56.0	5.1
2013	18,922	34.1	9.7	56.2	5.1
2014	18,928	35.6	10.0	54.4	5.2

Source: Austrian Financial Market Authority, Statistics Austria. – [1] On the basis of direct domestic premiums charged.

In 2014, internationally active Austrian insurance companies raised 49 percent of their total premium revenues abroad, unchanged from the previous year.

Austrian insurance companies keenly use the possibility of expanding their business operations within the EEA. During the last few years, they set their focus on East-Central Europe, although weak economic growth in the region continued to weigh on premium revenues. The latter amounted to € 6.3 billion in 2014, down 2.2 percent from the year-earlier level; premium revenues from non-EEA markets of € 0.7 billion even fell by 10.1 percent against the previous year. Gains in Western Europe compensated for these losses, as total revenues earned abroad rose by 1.5 percent to € 9.6 billion. The share of foreign premiums in total premium revenues earned by Austrian insurance groups remained virtually unchanged at 49 percent (2013: 49.1 percent).

The projection of premium revenues for Austria is complicated by the erratic behaviour of single premium payments.

The high volatility of single premium payments complicates projections of premium revenues at the moment. For 2015, the Association of Austrian Insurance Companies (Verband der Versicherungsunternehmen Österreichs) expects revenues to stagnate (+0.5 percent), with life insurance premiums set to decline by 2.4 percent and those for non-life and accident insurance to rise below-average (+2.2 percent); prospects for health insurance remain stable at +3.2 percent. On the basis of the latest GDP projection by WIFO, insurance penetration will edge down to 5.1 percent of nominal GDP in 2015.

After a three-year decline, non-life insurance in Western Europe returned to growth; life insurance rebounded markedly.

In 2014, the Western European insurance market was overshadowed by sluggish economic growth. Premium revenues in non-life insurance tentatively recovered from a three-year decline (+0.6 percent in real terms on a dollar basis). The UK (+1.7 percent), Germany (+1.3 percent) and France (+1 percent) enjoyed above-average market growth since in all three cases price hikes were achieved. Business receded in Italy (–3 percent) and Greece (–8.4 percent), whereas markets in Spain and Portugal returned to growth (*Swiss Re*, 2015). Life insurance premium revenues in Western Europe rose by 5.8 percent (in volume, on a dollar basis), with the sale of saving products dominating. Italy (+23 percent) and Portugal (+13 percent) posted strong gains, whereas the life insurance market contracted significantly in the Netherlands (–11 percent). *Swiss Re* (2015) explains the setback in the Netherlands by a shift in demand towards tax-privileged bank products and a loss in confidence in life insurance products. Non-life insurance developments in East-Central and South-Eastern Europe were uneven in 2014. Markets in the Czech Republic (+1.5 percent) and Hungary (+3 percent) expanded, while in Russia (–0.3 percent) and Ukraine (–15 percent) weak business activity and the territorial conflict left their marks. Taken together, the life insurance market in CESEE countries shrank by an overall 2.1 percent (adjusted for inflation, on a dollar basis). The main reasons were cuts in tax subsidies and low returns on investment.

1. New Insurance Supervisory Act implements latest EU guidelines

With the adoption of the Insurance Supervisory Act 2016 (Versicherungsaufsichtsgesetz – VAG) in February 2015, the legal base for insurance supervision in Austria has been restructured and aligned to provisions of the EU guidelines Solvency II and Omnibus II. With these guidelines, the EU will introduce (for the insurance industry) a risk-based three-pillar supervision; similar to Basle II for the banking sector. The first pillar contains quantitative requirements for the computation of solvency capital levels. Regulations for insurance supervision and principles for business operations and effective risk management are part of the second pillar, which also provides for a new within company governance system. These new principles oblige companies to a forward-looking assessment of operational risks and to enhanced reporting to national supervisory authorities. By issuing new publication requirements for companies, the third pillar is supposed to ensure transparency to market participants.

The new Insurance Supervisory Act 2016 represents the top layer of the legal framework for the insurance industry, below which there are implementing regulations and technical standards.

The VAG 2016 represents only the top layer of the new legal framework for the insurance industry (level 1), below which there are two more layers: in a level-2 Regulation (Regulation (EU) 2015/35 of 17 January 2015), the European Commission has specified details for the implementation, and it will further set technical standards by level-3 implementation rules on the basis of draft elaborations by the EU-wide European Insurance and Occupational Pensions Authority (EIOPA). In addition, the insurance sector awaits for 2015 the issue of further 27 guidelines by EIOPA and 30 implementing regulations by the national FMA. With these moves, the supervisory response to deficits in the regulation of financial intermediaries revealed by the financial market crisis will be completed within the fast-track "Lamfalussy procedure". What remains are legal concerns raised against the simultaneous exertion of legislative and administrative functions by EIOPA.

The second pillar of Solvency II also includes demands on improved effective governance within companies.

In response to Solvency II, Austrian insurance companies are bound to adapt their operational structure and to implement four control functions (risk management, compliance with legal rules, internal control and internal audit, and actuarial) that are to be exerted in units separated from operational departments like product development, distribution, claims settlement, information technology, and capital investment. In order to avoid supervision to be circumvented by outsourcing, the latter has to be reported to FMA; in addition, an "outsourcing representative" of the insurance company has to evaluate contractual partners and supervise them on a regular basis. For the sake of documentation of business operations, insurance companies shall henceforth establish three different financial accounts: one according to Austrian standards based on the Unternehmensgesetzbuch for the purpose of profit distribution to customers, one for the supervising authority following Solvency II criteria, and another one based on IFRS rules, if equity or debt is raised by issuing securities.

The changeover from the standard model for the calculation of solvency capital to an internal model adds considerable fixed cost, but lowers costs of capital.

The risk-based calculation of solvency capital may in future be carried out by using a standard model provided by the supervisory authority or by developing and implementing an internal model. Most companies will for this purpose use the standard model; large and internationally operating insurance companies will, however, take advantage of using internal models and thereby succeed in lowering their need for solvency capital vis-à-vis results produced by the standard model. Until now, insurance companies in Germany and Austria were only to a limited extent able to save cost by increasing their scale; i.e., their total premium revenues (*Mahlberg – Url*, 2003, 2010, *Cummins – Klumpes – Weiss,* 2015). Lower costs of capital resulting from applying internal models and higher fixed costs from additional control functions may, however, reinforce existing economies of scale and lead to further market concentration in the years to come.

Further negotiations on the Insurance Distribution Directive IDD aim at reinforcing consumer protection.

Further regulations at the EU level concern the distribution of insurance products. They are currently at an advanced stage of discussion between the EU Council, the European Commission and the European Parliament. New provisions will enter into force by early 2018 for life insurance under the Insurance Distribution Directive (IDD), which shall mitigate the conflict of interest between customers and the insurance intermediaries. The IDD obliges intermediaries and insurance companies to establish appropriate internal processes for identifying, preventing and solving conflicting interests. If this cannot be achieved, conflicts have to be revealed to customers in due time before the conclusion of a contract. Qualitative requirements for the design of commission fees and bonus payments for the distribution of insurance products are also under discussion. The IDD will furthermore clarify information and reporting requirements, rules for the analysis of customer needs, appropriate training standards for agents and brokers, for cross selling and for in-house product control and surveillance. An EU-wide ban on commission fees is not being envisaged.

Already in 2014, further duties of consumer information were stipulated for insurance investment products whose returns are subject to market volatility, by means of a key information document for packaged retail and insurance-based investment products (PRIIPs). The details for the key information document shall be elaborated by the end of March 2016 by the three European supervisory authorities, i.e., the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA), and the European Securities and Markets Authority (ESMA).

Compulsory requirements for basic consumer information to be given at the conclusion of unit- or index-linked insurance contracts are currently being elaborated.

The impact of transparency regulations on the demand for insurance is a matter of theoretical controversy. Models assuming rational investors predict that providing additional information and disclosing commission fees will change decisions by private households for the better. Models inspired by behavioural economics (*Kahneman – Tversky*, 1979), on the other hand, do not exclude unfavourable decisions even under an extended information set. As *Huber – Gatzert – Schmeiser* (2015) demonstrate in an experiment with 650 Swiss test persons of age 25 to 35, differences in packaging and presenting the cost of guarantees or administration of a unit-linked life insurance contract have no statistically significant influence on their consumer decision.

Test results for Switzerland suggest that the way of presenting relevant information has little influence on customer decisions.

The introduction of Solvency II is a consequence of the financial market crisis and the ensuing massive public subsidisation of financial intermediaries. The adoption of risk-based methods for the calculation of solvency capital requirements from credit institutions and investment banking (Basle II) to the insurance sector is nevertheless problematic from the Austrian perspective, since it allows price fluctuations on capital markets to be directly transmitted to the solvency balance of insurance companies. In this case, even conservative asset investments are made liable to arbitrary solvency requirements (e.g., real estate at 25 percent). The instruments previously used by insurers to secure operational viability, such as

Strong variations in solvency capital may complicate the business activity of mutual insurers.

- the cautious built up of actuarial reserves,
- their control by an actuary,
- the allocation to and drawing on hidden reserves,
- the allocation to provisions for premium refunds and profit participation, and
- the steady build-up of appropriate actuarial reserves

had a smoothing impact on solvency capital requirements. Going forward, stronger volatility in solvency capital requirements, together with already mentioned increasing returns to scale for large insurers, will create more pressure on companies with limited access to capital markets to exit the Austrian insurance market (e.g., mutuals).

2. Insurance products driving overall inflation

Headline inflation, as measured by the Austrian consumer price index, dropped in 2014 somewhat below the close-to-2 percent target of the ECB, with insurance products showing above-average price increases (Table 2). Driven mainly by home insurance and partially comprehensive car insurance, insurance services contributed nearly 0.1 percentage point to the overall inflation rate. Motor third party insurance and legal costs insurance for cars rose below average. Data for January to July 2015 suggest that the contribution of insurance products to overall inflation will stay broadly unchanged.

Claims payments are the key factor in insurance companies' price formation, since expected claims ought to be covered by customers' premium payments and investment returns. An interesting indicator for future price pressure is therefore the claims ratio which sets insurance payments against premium revenues. With regard to the industry's experience, 2014 was an average year: 67.5 percent of premium revenues in non-life and accident insurance were directly spent on insurance claims, in line with the long-term average (1983-2014). A claims ratio significantly above the average was only observed in fire and business interruption insurance (135 percent), where claims volatility is usually very high. For householder's comprehensive insur-

The claims ratio stayed close to its long-term average in 2014. For householder's comprehensive insurance and motor passenger accident insurance there appears scope for premium cuts.

ance and passenger accident insurance, claims ratios were again low in 2014, offering some leeway for premium cuts.

Table 2: Private insurance items in the basket for the consumer price index

	2015 Weight in percent	2010	2011	2012	2013	2014	2015[1]
		Percentage changes from previous year					
Statutory premium							
Householder's comprehensive Insurance	0.297	+ 2.0	+ 1.9	+ 2.7	+ 2.5	+ 2.1	+ 1.6
Home Insurance	0.705	+ 1.6	+ 3.5	+ 2.6	+ 3.2	+ 3.9	+ 1.6
Private health Insurance	1.760	+ 2.3	+ 2.2	+ 2.1	– 1.3	+ 1.7	+ 2.8
Motor third party Insurance	0.885	+ 1.8	+ 2.7	+ 3.3	+ 2.0	+ 1.6	+ 1.4
Legal costs insurance for cars	0.038	+ 0.0	+ 1.3	+ 2.4	+ 1.9	+ 1.0	+ 1.4
Partially comprehensive car Insurance	0.543	+ 5.6	+ 3.3	+ 1.3	+ 3.2	+ 2.3	+ 0.9
Private insurance forms, overall	4.228	+ 2.5	+ 2.5	+ 2.3	+ 1.0	+ 2.2	+ 1.9
Consumer price index overall		+ 1.9	+ 3.3	+ 2.4	+ 2.0	+ 1.7	+ 1.0
Contribution private insurance (percentage points)		+ 0.11	+ 0.12	+ 0.10	+ 0.04	+ 0.09	+ 0.08

Source: Statistics Austria. – [1] January to July.

The consumer price index measures price changes for insurance products on the basis of standard contracts, thereby ignoring price cuts due to re-classification into lower bonus ranks, rebates and premium redemption. The evolution of the average premium per insured risk better captures such special factors, although it also includes changes in insurance coverage. In motor car insurance, the average premium per risk declined by 1 percent from the previous year, while in the (quantitatively less important) passenger accident insurance it fell by no less than 10 percent. As revealed by a comparison with the CPI, the discrepancy between the official statistics and the average premium remained unchanged in 2014. Yet, the non-life insurance saw a distinctly smaller increase in its average premium, indicating a rise in competitive pressure.

The average premium per risk declined by about 1 percent in motor car insurance, while it rose moderately in non-life insurance.

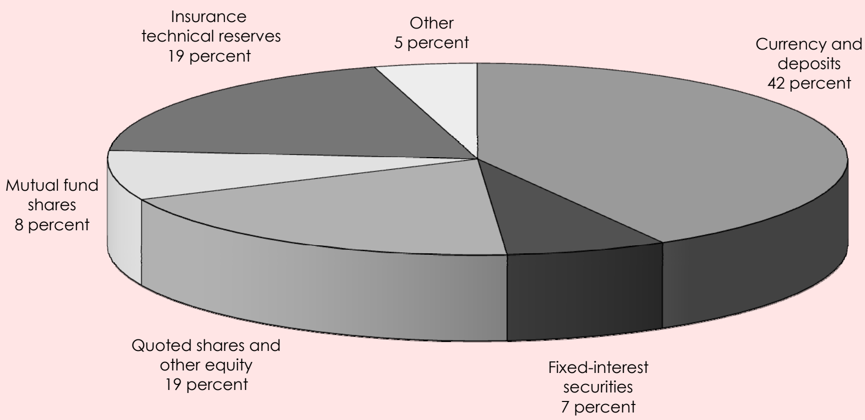
3. Single premium payments give a boost to life insurance

General economic conditions were difficult for the life insurance business also in 2014. Real disposable income of private households stagnated, as did the private saving ratio, such that the potential flow of financial resources, when adjusted for inflation, remained unchanged. At the same time, the yields on safe investments hit new lows. Austrian government bonds with a time to maturity of 10 years carried a yield of no more than 1 percent in 2014. The return on higher-risk assets was driven by losses on Austrian shares (ATX –13.2 percent) together with strong gains on foreign shares (MSCI World converted into euro +20.6 percent). Private household financial assets increased by an overall 2.6 percent in 2014, with its composition shifting from cash, deposits, and fixed-interest securities to mutual fund investment certificates and claims vis-à-vis pension funds. The share of life insurance products remained unchanged at 12.6 percent of total financial assets (Figure 1).

Single premium payments stimulated the life insurance business. A major reason for the revival of demand were echo effects of tax breaks introduced in 1999 and 2000.

Insurance companies recorded 1.98 million new life insurance contracts; the increase by 12.4 percent compensated part of the setback suffered in 2013. Premium revenues rose by 4.5 percent, with only small parts of the business ceded to reinsurers (Table 3). Demand was most buoyant in the important sectors of endowment (+33.6 percent) and residual debt insurance (+43.6 percent). This did not come altogether unexpected since the statutory minimum term for single payments in life insurance was shortened from 15 to 10 years as of 1 March 2014, if beneficiaries had completed the age of 50 at the conclusion of the contract (BGBl. I Nr. 13/2014). The effect of this tax privilege was reinforced in 2014 by a significant increase in life insurance claims (+24.3 percent), an echo effect from 1999 and 2000. The increase in endowment insurance contracts at the time had also occurred during a period of low interest rates; in addition, demand had been fuelled by early political debates about pension reforms and by strong age cohorts entering the life cycle phase with strong savings accumulation (*Url*, 2000, 2001). Households predominantly reinvested their expiring insurance policies in low-risk life insurance products.

Figure 1: Composition of private financial wealth, 2014



Source: Austrian Nationalbank. Total financial wealth: € 572 billion.

2014 was a successful year for residual debt insurance, due to lively demand for new mortgages and a strong increase in commercial trade credits.

The boom in residual debt insurance is another consequence of persistently low interest rates. Low returns on financial investment and historically low interest rates have massively increased the demand for real estate in Austria. From the onset of the financial market crisis in February 2007 (*Url*, 2009) to the first quarter 2015, real property prices climbed by 47.1 percent on national average (Vienna +75.3 percent)[1], compared with an increase in the overall consumer price index by 17.4 percent. On the back of favourable financing conditions, purchases of real estate were increasingly financed by credit in 2014, with outstanding liabilities being hedged via residual debt insurance. The extension of new credit for housing purposes rebounded by 13.7 percent in 2014 and fuelled demand for residual debt insurance, together with a hefty increase in trade credits by non-financial enterprises (+33.4 percent).

Since the subsidy for state-aided old age insurance has been cut in 2012, demand for new contracts has been sluggish. Due to low bond yields, the subsidy rate on new deposits is kept at the minimum 4.25 percent.

Over the last years, the number of state-aided old age insurance contracts has stagnated around 1.5 million, with insurers' premium revenues totalling about € 1 billion. Unlike comparable products offered by mutual funds, the insurance industry was able to maintain its business volume despite the fragility of the Austrian stock market. Demand for new contracts nevertheless is subdued, after subsidy rates had been cut by 50 percent in 2012. The average premium amount rose from € 637 in 2013 to € 648 in 2014.

The subsidy rate for state-aided old age insurance is linked to the yield on federal government bonds. The calculation formula for the variable part of the subsidy rate would produce a value of 3.25 percent, but in compliance with the legal minimum level the subsidy rate will remain constant at 4.25 percent in 2016.

The surplus on insurance companies' financial operations mirrored the decline in government bond yields more clearly in 2014 than in previous years. Lower gross returns from capital investments and interest earnings of € 2.8 billion were accompanied by higher expenditures on write-downs and interest of € 0.8 billion, leading to a

[1] *Oesterreichische Nationalbank* Residential Property Price Index, https://www.oenb.at/isaweb/report.do?lang=EN&report=6.6.

declining surplus on financial operations (Table 3). Actuarial reserves were nevertheless reinforced to an above-average extent in 2014. The strongly improved balance of other non-actuarial operations did not offset weaker earnings from current operations of € 281 million; the rate of return on equity in the life insurance branch thus declined from 11.9 percent in 2013 to 9.2 percent in 2014.

In 2014 insurance companies achieved a much lower surplus on their financial operations than in the year before and also suffered losses from current operations.

Table 3: Life insurance

	Premiums gross	Premiums net[1]	Retention rate	Surplus on financial operations	Claims payments	Increase in actuarial reserves
	Adjusted Million €		In percent		Million €	
2010	7,483	7,268	97.1	2,208	5,854	3,221
2011	6,939	6,704	96.6	1,846	6,651	316
2012	6,488	6,269	96.6	2,200	6,407	2,448
2013	6,454	6,345	98.3	2,182	6,369	1,189
2014	6,745	6,631	98.3	2,028	7,177	1,428
	Percentage changes from previous year					
2010	+ 1.1	+ 1.1	− 0.0	+ 17.3	+ 1.0	− 1.1
2011	− 7.3	− 7.8	− 0.5	− 16.4	+ 13.6	− 90.2
2012	− 6.5	− 6.5	+ 0.0	+ 19.2	− 3.7	+ 675.9
2013	− 0.5	+ 1.2	+ 1.7	− 0.8	− 0.6	− 51.4
2014	+ 4.5	+ 4.5	+ 0.0	− 7.1	+ 12.7	+ 20.1

Source: Austrian Financial Market Authority. – [1] Estimate.

4. Unexpectedly strong increase in health insurance claims

The Austrian federal government tries to implement cost savings in primary health care. In mid-2014 the Federal Steering Committee ("Bundeszielsteuerungskommission") reached an agreement with the social security administration and the medical association (*Federal Ministry of Health,* 2014). Patients shall in future receive comprehensive medical services already at the initial stage, i.e., by the general practitioner in collaboration with a multi-professional and inter-disciplinary team. The general practitioner (family doctor) shall coordinate these services and decide whether to refer patients to the second stage. The purpose is to relieve the second, more costly stage that includes medical specialists and outpatient clinics. So far, however, no limitation of direct access to the second stage has been established; hence, apart from improvements in the supply of primary services, there is no incentive for patients to change behaviour.

Public expenditure on health care exceeded the target in 2014, mainly due to rising costs of prescription drugs.

Public health insurance expenditure increased by 3.8 percent in 2014 from the previous year, thereby exceeding the target of +3.6 percent set by the Health Target Steering Act ("Gesundheits-Zielsteuerungsgesetz"). While the outlays for doctors' services rose below-average (+2.4 percent), those for prescription drugs expanded more swiftly (+5.4 percent). Upward pressure on expenditures derives from rising employment: the number of persons covered by public health insurance went up by 1 percent in 2014, the number of hospital treatments by 0.6 percent. The trend towards shorter stays in hospital continued, as the number of days spent in hospital declined by 0.8 percent from 2013.

The number of persons covered by private health insurance increased in 2014, with premium revenues remaining on a stable growth path.

Private health insurers again recorded a robust growth of insured risks in 2014 (+2.4 percent), with individual insurance faring somewhat better than group insurance. Premium revenues have followed a steady upward path over the last years (Table 4). The lively growth of the risk pool has been accompanied by a moderate increase in the average premium per risk (+0.9 percent), possibly the result of a lower scope of coverage or higher deductibles. With a price increase for private health insurance services of 1.7 percent according to CPI data (Table 2), average premiums even edged down in real terms.

Table 4: Private health insurance

	Premiums gross, adjusted	Claims payments	Claims ratio	Surplus on financial operations	Increase in actuarial reserves
	Million €		In percent	Million €	
2010	1,644	1,126	68.5	163	277
2011	1,704	1,145	67.2	143	305
2012	1,762	1,192	67.6	160	302
2013	1,828	1,231	67.3	207	326
2014	1,889	1,262	66.8	194	345
	Percentage changes from previous year				
2010	+ 2.8	+ 1.0	– 1.8	+ 32.2	+ 6.8
2011	+ 3.6	+ 1.7	– 1.8	– 12.3	+ 10.2
2012	+ 3.4	+ 4.0	+ 0.6	+ 12.0	– 1.2
2013	+ 3.8	+ 3.3	– 0.4	+ 29.2	+ 8.0
2014	+ 3.3	+ 2.5	– 0.7	– 6.4	+ 6.0

Source: Austrian Financial Market Authority.

The strong increase in insurance claims in 2014 did not fully translate into higher claims payments.

The performance data for public health insurance would suggest a benign scenario for private insurance companies. Like in 2013, however, developments in private insurance deviated strongly from those in the public domain, as the number of claims rose by 9.7 percent. This increase only partly translated into higher expenditures, such that the claims ratio even declined slightly. In the lasting low-interest-rate environment insurers find it increasingly difficult to use existing smoothing instruments for stabilising financial returns. Hence, like in the case of life insurance, the surplus on financial operations was subdued. The below-average allocation to actuarial reserves allowed for earnings from current operations of € 120.5 million and a return on equity of 33.5 percent (2013: 37.8 percent).

5. Decline in premiums and claims payments in non-life and accident insurance

Measures to increase road safety are proving successful. While cases of damage in accident insurance rose markedly, their number declined in motor car insurance.

Non-life and accident insurance companies expanded the number of insured risks to a total 35.9 million (+1.3 percent) in 2014. The major part were property insurance risks (21.5 million), with motor car insurance (10.1 million) being the most important branch. Despite moderate price increases (Table 2) and the higher number of insured risks, premium revenues receded in 2014 (Table 5).

Table 5: Non-life and accident insurance

	Premiums gross, adjusted	Surplus on financial operations	Claims payments	Increase in actuarial reserves
	Million €			
2010	9,586	828	6,323	21
2011	10,279	901	6,690	31
2012	10,493	1,046	7,086	12
2013	10,639	961	7,194	14
2014	10,294	928	6,944	10
	Percentage changes from previous year			
2010	+ 5.2	+ 18.8	– 7.2	+ 87.1
2011	+ 7.2	+ 8.8	+ 5.8	+ 49.7
2012	+ 2.1	+ 16.2	+ 5.9	– 60.4
2013	+ 1.4	– 8.1	+ 1.5	+ 12.3
2014	– 3.2	– 3.5	– 3.5	– 28.3

Source: Austrian Financial Market Authority.

Insured cases of damage in this sector evolved quite differently in 2014: a strong increase in accident insurance (+8.3 percent to a total of 222,000) was in contrast to a moderate gain of 1.9 percent (to 1.8 million) in non-life insurance and a decline in motor car insurance (–3.4 percent to 1.3 million). The measures to enhance road safety are proving successful. In 2014, 37,957 (–1.4 percent) accidents were recorded; with fewer people injured, the number of traffic deaths fell to a new low of 430. Despite an overall stable number of claims, non-life and accident insurance claims payments were lower than in the year before (Table 5).

Like in the other insurance categories, the surplus from financial operations declined in non-life and accident insurance. The actuarial result fell by more than one-third from the previous year, but stayed positive. With regard to the expected low financial returns, the insurance industry stayed on course towards establishing a sustainable business model. From a peak in 2013, the earnings from current operations subsided to a total of € 950 million, with a return on equity of 9.4 percent (2013: 10.3 percent).

The actuarial result of non-life and accident insurance remained positive in 2014. The sector thereby got over its long-standing dependence on surpluses from financial investments.

6. Insurance companies achieve positive returns on their financial investments

With the period of low interest rates persisting, WIFO expects yields on 10-year government bonds to stay at a low 1 percent in 2016 (*Scheiblecker,* 2015). Benefiting from low nominal interest rates, the public sector is likely to continue reducing its indebtedness even beyond 2016. Results by *Reinhart – Sbrancia* (2015) suggest that after capital controls have been waived in the EU, institutional investors are induced to invest in fixed-interest government bonds issued by fiscally sound countries by imposing risk based solvency capital requirements. Since the euro-area-wide inflation is substantially below the target rate of the ECB, the latter also exerts pressure for low nominal interest rates ("quantitative easing"). Higher rates of inflation would accelerate the de-leveraging process for public debt, but are currently not in sight. The decline in world market commodity prices has an exonerating effect on European capital markets as it lowers notably the financial surplus of oil producers and thus their supply of capital on European bond markets.

Table 6: Insurers' return on invested capital

	Yield on government bonds	Life insurance	Health insurance	Non-life and accident insurance
	Rate of return in percent			
2010	2.5	4.5	3.9	3.9
2011	2.6	3.7	3.3	3.9
2012	1.5	4.4	3.5	4.5
2013	1.1	4.3	4.0	4.0
2014	1.0	3.9	3.5	3.9

Source: Austrian Financial Market Authority, WIFO calculations.

The insurance industry is adversely affected by this development, since the surplus on financial investment is a key source of revenue. At permanently low returns on capital, insurance companies have to compensate the foregone financial earnings via their actuarial operations, i.e,. by either raising premium rates or cutting cost. In life insurance, returns on capital are a major incentive for private household retirement saving as well as for businesses offering supplementary pension insurance schemes to their staff. Insurance companies have managed so far to extend rather high financial returns (relative to capital market rates) to their clients, thanks to a combination of long-term investment strategies, the accumulation of hidden reserves, the allocation to provisions for premium refunds or profit participation, and the steady build up of actuarial reserves. From their overall investment of € 84 billion[2], insurance companies earned returns between 3.5 and 3.9 percent in 2014, thereby maintaining a positive premium of around 3 percentage points over government yields (Table 6). The persistence of negative real interest rates puts at risk the build-up of the second and third "pillars" of private old age provisions.

The period of low interest rates is set to persist in the foreseeable future. Non-life insurance is therefore exposed to premium hikes, and life insurance loses a powerful incentive for private retirement saving.

[2] Bank deposits, securities, outstanding loans, insurance policy loans, real estate, shares and other assets.

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